File – 204

JEL

30 May 2003

Mr Andrew Reeves
Commissioner
Government Prices Oversight Commission
GPO Box 770
HOBART
TAS 7001

GPOC Draft Report – Metro Pricing Policies Investigation

Dear Mr Reeves

I refer to GPOC's Draft Report released on 14 May 2003. Please find attached Metro's response to the conclusions that have been reached in that draft report.

Metro is willing to meet with officers of GPOC to elaborate or explain any of the issues addressed in the attached document, or to discuss any other issues that you may require our input on.

Metro has asked INDEC to provide a response to the conclusions GPOC have reached regarding efficient costs and private sector benchmarks. A copy of their response will be provided to the Commission as soon as practical.

INDEC's Benchmarking report was supplied to GPOC on a confidential basis, and a range of material from that report has been reproduced in the GPOC draft report.

It was not possible, in the time provided, for Metro to check with INDEC if the material that GPOC intended to reproduce created problems for INDEC with respect to the conditions on which the material was supplied to them. INDEC have indicated that the extent of material reproduced by GPOC has caused them some difficulties. Adequate time needs to be provided to check with INDEC prior to the release of the final report.

Yours sincerely

Laurie Hansen

Chief Executive Officer

Response

By

Metro Tasmania Pty Ltd

To The

Government Prices Oversight Commission

May 2003 Draft Report

Metro's Pricing Policies Investigation

May 2003

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INTRODUCTION

On 14 May the Government Prices Oversight Commission (GPOC) released the *Metro Pricing Policies Investigation – Draft Report.* The Commission sought responses to the draft report by 30 May 2003.

This document represents Metro's response to the GPOC report.

Metro officers are available to meet with GPOC to expand or explain any of the issues identified in this document, or to provide a response to any of the conclusions reached or points made in the GPOC Draft Report and which have not been adequately addressed in this response. Because of the tight timeline it may be that there are issues that the Commission would wish to explore further and which have not been adequately addressed in this response.

The draft GPOC report draws conclusions and makes recommendations with regard to:

1. service effectiveness
2. service efficiency and financial performance
3. maximum revenues
4. maximum fares
5. the Community Service Activity Agreement; and
6. the Metro Index

Metro's comments in relation to these matters are detailed below.

1 SERVICE EFFECTIVENESS

GPOC have no other basis for assessing effectiveness than to use the "shareholder expectations" provided to it in the terms of reference.

Metro notes that work is currently being undertaken by DIER to measure effectiveness in terms of accessibility to various community services. It is probable that this will assist the Commission in the longer-term, as well as assisting Metro and the Department to address this issue in a more rigorous way.

The Commission has identified three measures of effectiveness:

- First Boardings per "in-service" bus-kilometre;
- Complaints per million first boardings;
- Assessment of performance against the Customer Service Charter.

The only comments that Metro would wish to make in relation to the Commission's conclusions in this regard are that:

- The use of bus-kilometres is a more practical measure than in-service bus kilometres in that it is a more reliable measure if comparisons are to be attempted between jurisdictions.

Whichever measure of kilometres is used, great care is required to interpret what the measure actually means through time. If Metro was free to be able to control the level of bus-kilometres and their allocation, and the demand for public transport was reasonably stable, then this indicator would be a good measure how well Metro matches services levels to meet passenger demand.

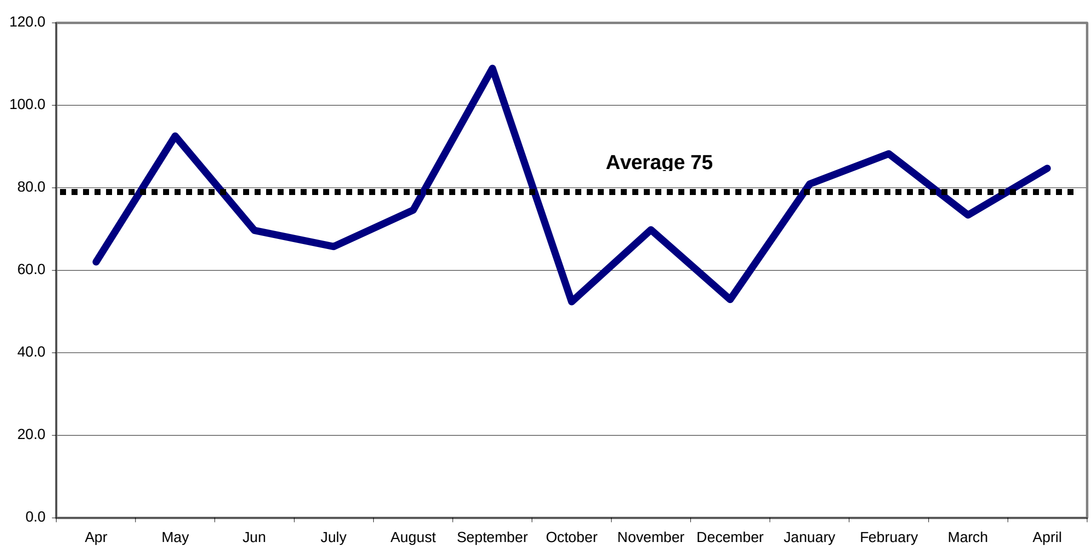
However, Metro does not have full control over bus kilometres. Metro's service contract specifies the in-service kilometres to be delivered and also specifies the schedule to be operated. Variations are permitted, but they are not at the discretion of Metro.

In addition, the long-term demand for public transport is affected by a wide range of factors such as car ownership levels, population growth and changes in fares.

The net result is that it is not possible to conclude that Metro is less effective in service delivery, if this indicator has declined through time.

- Complaints per million first boardings is seen as a useful guide as to what our customers think of our service. Figure 1 illustrates more up-to-date information than that which was available to the Commission through the original Metro submission. The average for the available data period is 75. Anecdotal evidence is that there are more complaints after changes or when new passengers use Metro services (such as at the start of a school year). This information provides a guide to the trend for Metro. However, there is also a need for comparable statistics from other jurisdictions or similar businesses before it can be said if the level of complaints is high or low.

Figure 1: Complaints per Million First Boardings



- Metro uses Birkett & Associates to regularly monitor and report upon its performance against the Customer Service Charter. These survey reports tend to indicate that Metro has achieved a high level of service and is maintaining that performance.

On the available evidence Metro believes that it has demonstrated that it is effective in service delivery. This is in line with the conclusions reached by GPOC.

2 SERVICE EFFICIENCY AND FINANCIAL PERFORMANCE

Metro notes that the Commission has relied heavily on material supplied to it by Metro as a result of consultant work undertaken by INDEC consulting.

The INDEC survey concluded that Metro was by far the most efficient public sector bus operator in Australia and was on par with average benchmarks for mainland private sector operators. The Commission have then taken the position of what Metro could, or should, achieve if it operated in line with “best practice” mainland private sector benchmarks without adequately exploring the potential for that to occur given the constraints within which Metro operates. This presents a false impression about Metro’s efficiency, and could provide the community and Government with unrealistic expectations about what Metro can achieve.

Metro has provided a copy of the draft GPOC report to INDEC and has asked them to comment on the “efficiency” elements of the document. A copy of their response will be provided to the Commission as soon as it is available.

The following comments are provided by Metro on the conclusions of section 4 of the draft GPOC report.

In section 4.3.2 the Commission indicates that Metro is not subject to the Government’s dividend policy. Metro’s contract payments are calculated on the basis of achieving a break even return, which should result in a zero dividend. However, Metro is still subject to the Government’s dividend policy if it achieves a profit in any financial year. Metro has paid the Government 70% of its pre-tax profits for two of the last three financial years.

Sections 4.4 and 4.5 present analysis of the efficiency of Metro’s operations, with keys details presented in tables 4.4 and 4.6.

Metro’s comments on the Commissions primary conclusions as set out in table 4.6 are designed to assist the Commission answer two basic questions:

- Is like being compared with like in relation to a particular component of expenditure?
- Are there any constraints that could prevent a particular efficiency factor being achieved or alter its magnitude, or are there other issues that need to be taken into account?

Metro believes that it is critical that the conclusions reached by GPOC meet tests of comparability and practicality.

In table 4.6 of the GPOC report the Commission indicates that the following efficiencies can be generated:

- Driver wages - $625,000
- Mechanics, Cleaners % Refuellers wages - $610,000
- Bus Parts & Material costs - $152,000
- Overheads - $177,000.

In providing information in its report INDEC attempted to adjust expenditure and revenue details to enable a more direct comparison with other bus operators by:

- Treating diesel fuel grants as a revenue source for Metro (rather than reduced expenditure) given that operators in mainland capital cities would not receive the fuel grant; and
- Adjusting the “average best practice” operator’s figures for the lower levels of charter activity by Metro.

Metro submits that there are also a number of other factors that it has not been possible for INDEC to adjust for, but which could impact on the comparisons between Metro and the “average best practice” operator. These include:

- Differences in the time distribution of work – Mainland operators tend to have wider peaks and higher levels of off-peak services. The more even the distribution of workload, the more effective the utilisation of labour can be. [1]
- Differences in work-force composition – a workforce with a higher proportion of casual labour can achieve a closer match between the supply of and demand for labour
- Depot structure and service area – An operator with one single depot and a more consolidated service area is able to perform more efficiently than an operator with 3 depots and a dispersed operation. Metro has three depots (Hobart, Burnie and Launceston) spread throughout Tasmania. Further, even within a given region, Metro is unable to benefit from a more compact operation due to the impacts of topography and rivers.

Metro will identify the effects of these and other differences when commenting on specific efficiency factor proposals below.

Drivers

The first major efficiency factor relates to driver wages.

In preparing the Metro base expenditure data INDEC have allocated a certain amount of driver time to refuelling, cleaning and supervision activities.

Further questioning of INDEC on the comparability of Metro and the “average best practice” benchmark for this factor indicates that a number of private operators have not been able to separate out time spent by drivers in cleaning and refuelling activities. The impact of this on the data in Table 4.4 is unclear. Further advice is being sought from INDEC.

Table 4.4 identifies “variance %” as 96.8% for driver wages, and yet GPOC uses an efficiency factor of 95% in table 4.6. The factors identified by the Commission for adopting an efficiency factor below 100% are inherent in the data used to create table 4.4. It is not clear on what basis the lower efficiency factor has been adopted. This has an impact of over $226,000 on the Commission’s conclusions.

[1] In its supplementary submission Metro indicated that INDEC had made adjustments for both charter differences and differences associated with different peak characteristics. Further clarification with INDEC has confirmed that adjustments were only made in relation to charter work. Metro apologises for any confusion created.

GPOC has identified, on page 39 of its report, that the Commission has not made any adjustments to benchmark hourly rates because of the "no detriment provisions" associated with the Torrens Transit case.

The principles established by the Torrens Transit case not only cover hourly wage rates but also all other components of employment conditions contained in awards or workplace agreements.

The Commission has not provided specific guidance as to the process that it envisages for achieving these efficiencies. Two areas appear to have been highlighted - the more extensive use of casual workers and modifications to employment conditions to enable more flexible use of labour.

Metro understands that the operators represented in the "average best practice" benchmark have developed more flexible employment practices and conditions through a process in which service contracts were subject to competition. In some circumstances the Government (as the purchaser of the bus services) has underwritten transitional costs associated with moving from one set of employment practices and conditions to another.

It is Metro's view that the process required to achieve the changes in employment conditions identified by GPOC needs to be clearly spelt out and any transitional costs associated with that process identified together with responsibility for funding those costs.

Metro believes that it is important that the process envisaged by the Commission for achieving their efficiency recommendations needs to be consistent with established Government policy. For example, it is Metro's understanding that the Government does not currently have a policy for awarding bus contracts through a competitive tendering process. Further, the Government has expressly stated that it does not intend to privatise Metro.

Metro believes that the achievement of efficiency targets such as those identified by GPOC could only be realised by substantial changes to employment conditions. Any such changes would have significant industrial relations implications. Any real chances of achieving such benchmarks will without doubt require transitional funds to buy out old conditions and replace them with new.

Metro is of the view that the efficiency target set by GPOC in relation to this area of expenditure is not achievable within the constraints that control its operation.

Mechanics, Cleaners & Refuellers

The next area of efficiency identified by GPOC relates to various components of "bus kilometre costs". In particular GPOC has identified potential efficiencies of:

- Mechanics, Cleaners & Refuellers wages - $610,000; and
- Bus Parts & Material costs - $152,000

There are a number of comments that need to be made in relation to these factors.

First of all there are 3 components to bus kilometre costs that must be taken together. The two identified above plus "bus maintenance".

If there is a greater level of external bus maintenance work (as opposed to in-house maintenance) then the level of "bus maintenance" expenditure will be higher (as the external maintenance contract will be costed here) and the level of expenditure on

internal labour and parts/materials will be correspondingly smaller. This is reflected in table 4.4 of the GPOC report where "bus maintenance" costs are $260,000 higher for the benchmark operator. The Commission has indicated that it has not made any allowances for this. Metro is of the view that it should.

Using table 4.4. data this would reduce the Commission's efficiency target from $762,453 to $503,089 for these elements. GPOC has indicated that it has made adjustments to take into account the fact that Metro drivers undertake cleaning and refuelling functions. Metro acknowledges this.

Metro accepts GPOC's implied conclusion that there may be potential efficiencies from increased outsourcing of maintenance work. This will need to be investigated in more detail by Metro.

In addition there are other reasons why expenditure in these areas will be higher for Metro:

- The existence of 3 depots each with its own facilities means that there are less economies of scale than the "average best practice" operator is able to enjoy with a more centralised operation;
- The cost of materials and parts is higher for Metro than a mainland bus operator due to the existence of transport costs and a less competitive market place;
- The terrain in Metro's operating area is hillier and this has an impact on vehicle maintenance costs in the same way that it has an impact on fuel consumption, which tends to be higher in Tasmania.
- Closer scrutiny of Metro data has identified a full-time employee currently costed to the work-shop area that is involved in the maintenance of on-street infrastructure and thus should be costed to overhead salaries.

For these reasons Metro is of the view that the efficiency targets set by GPOC are too high and cannot reasonably be achieved without seriously impacting upon the safety and reliability of bus operations.

Overheads

The next area of potential efficiency identified relates to overheads. A potential efficiency of $177,000 has been identified with half coming from salaries and half from non-salaries.

In undertaking its analysis of overheads INDEC noted that there are significant differences between the responsibilities of Metro and private sector operators in this regard. Four examples are:

- Metro spends significant resources on security whereas for the private sector operators, this responsibility has been accepted by Government;
- Metro provides and maintains ancillary infrastructure such as bus stops and shelters. This is a Government responsibility for most private operators[2].
- Metro undertakes a significant planning and timetable development role. By contrast many private operators deliver the timetable defined by Government.

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[2] Some private operators have responsibility to maintain infrastructure provided by Government.

- Metro is required to meet more onerous reporting requirements, meet Freedom of Information Act requirements, make submissions to various inquiries[3], report to Parliamentary scrutiny committees, and the like. Private sector operators do not have the same requirements placed on them. Metro is not commenting on the merits or otherwise of these requirements, but rather making the point that they all have a cost associated with them.

To try and remove these inconsistencies INDEC used Metro's non-salary overhead expenditures for the average best practice operator, except for minor adjustments to "advertising and promotions" and "other".

A particular problem that has been identified as a result of this approach is that in relation to overhead salaries the data presented for Metro includes internal resources associated with these extra tasks, whilst these costs are not included in the average best practice benchmark. A preliminary estimate of this element is that it equates to about 4-5 FTEs, possibly more.

Metro is also of the view that the modifications made by INDEC to non-salary overheads require closer scrutiny to establish their appropriateness. Metro is in the process of doing this.

Metro is of the view that the efficiency targets set by GPOC need to be adjusted in light of the above comments.

Capital

In table 4.4 GPOC identified differences between Metro and the average best practice benchmark related to capital (depreciation and debt servicing). This showed that the best practice operator spent significantly more than Metro ($4.48M versus $3.07M). No adjustments have been made to Metro's efficient costs in table 4.6.

In relation to depreciation the Metro figures are low by comparison to a normal operator because of the age structure of the Metro fleet[4]. Metro has only recently recommenced a vehicle fleet replacement program and so there are very few new vehicles in the Metro fleet (7 for the financial year being assessed by GPOC, and 10 per year thereafter). New vehicles have a higher depreciation rate and a higher value and thus impact on depreciation provisions.

As the number of replacement buses in the Metro fleet increases then the level of depreciation will also increase. This is evident in Metro's Corporate Plan, which indicates that depreciation will increase from the 2001/02 level of $2.84M to $3.33M over the next 3 years. This is higher than the $3.08M identified in table 4.4. for the best practice benchmark.

Metro's plant and equipment includes greater investment in buildings than would be the case for the "average best practice" benchmark". This is due to the number of depots and the historical investment made in the Springfield depot.

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3 A good example of the cost to Metro of inquiries is the cost to Metro of the GPOC review. This amounts to a direct cost of about $150,000 plus associated costs of staff time (a further $30-40,000).

4 Ideally the age distribution of a bus fleet should be fairly even so a constant number of buses are replaced each year. Metro's fleet age distribution is very uneven due to the high levels of fleet acquisition from Ansair, followed by six years (1995 to 2001) with no vehicle purchases.

Metro believes that the depreciation provision identified in table 4.6 needs to be increased to properly reflect this. A figure of about $3.2M in 2001/02 prices is considered more appropriate.

The lower debt servicing costs is primarily related to the lower levels of debt for Metro compared to the private sector. Metro has a current debt level of $3M and total assets of $37M. In the private sector the level of debt would probably be around $12-15M.

If Metro's finances were restructured so as to establish such commercial levels of debt then the "efficient Metro costs" defined in table 4.6 would also have to be increased to reflect the higher levels of interest payments

Profit/Return on Capital

Metro notes that in making comparison with the "average best practice" benchmark in table 4.4 no provision has been made for profit. INDEC estimates a normal commercial profit level at around $2.2M. In table 4.6 the Commission has identified a return on capital of 7% equivalent to $1.74M.

Metro notes that if Government purchased the urban bus services in Hobart, Launceston and Burnie under a contract with a private operator then provision for a commercial profit of around $2M would be necessary.

Metro is of the view that provision should be made for a return on capital in the calculation of Metro's CSA Contract Payment. The 7% return on capital of $1.74M identified by GPOC is a reasonable basis for this figure. Providing for such a return would be essential in an environment where the CSA Payment incorporates a higher per passenger payment component, as recommended by GPOC.

Efficiency Factor Conclusions

Metro is of the view that the efficiency targets identified by GPOC are not realistic.

If Government requires that Metro operate on par with "best-practice" private sector operators then Metro will have to embark on an aggressive approach of reviewing the employment arrangements and conditions of its workforce. To date Metro has adopted a strategy of incremental improvements in cost performance over time. This has delivered exceptional results placing Metro clearly at the top of organisations in similar ownership and operating circumstances. Metro's intention is to continue with this strategy.

As an observation, best practice operations are generally achieved in an environment where there is competitive pressure associated with the setting of contract conditions. This is normally obtained by the competitive tendering of service contracts. Current Government policy does not include the tendering of bus service contracts. The lack of such a regime results an organisation and workforce that lacks the external pressure to embark on and accept dramatic changes to enable it to be successful in a competitive environment.

Any changes to employment conditions and practices that are necessary to achieve best practice outcomes are likely to have transitional costs. These need to be identified and the implications for their payment understood.

Comparisons With Tasmanian Operators

In section 4.5 the Commission indicates that there is limited publicly available information to enable it to make a meaningful comparative analysis with the only other Tasmanian urban bus operator Merseylink.

Metro does not have the detailed information to enable it to make a direct comparison between itself and Merseylink with regard to the relative efficiencies of each operation.

However, the budget papers identify the level of CSA funding made available for 2003/04; Metro $20.877M and Merseylink $1.25M.

Metro's total route service kilometres are 10.2 million kilometres.

It is understood that Merseylink's total route service kilometres are between 460,000 and 500,000 kilometres[5].

Both businesses face the same operational environment[6]; they operate similar vehicles[7], apply the same fares structure and have net service contracts with DIER[8].

The Government contract payment for Metro services equates to $2.05 per kilometre, whilst the corresponding payment to Merseylink is $2.60 per kilometre.

Whilst a more detailed analysis is required to make a direct comparison, it remains an interesting observation that the cost to Government for the purchasing each kilometre of urban bus services in Devonport is 27% greater than in Hobart, Launceston and Burnie. In other words if the Government paid the same per kilometre for urban bus services in Metro areas as they do in Devonport, then Metro's contract payment for 2003/04 would increase 27% from $20.9M to $26.6M.

3 MAXIMUM FARES RECOMMENDATIONS

Adult Fares

GPOC recommend an increase in adult fares of 30%. In support of this recommendation GPOC present 3 arguments:

- average urban bus fares in Australian capital cities are about one third higher than Metro Adult fares;
- average fares on private sector buses in Tasmania are at least 30% higher than Metro Adult fares;
- a primary reason for Government subsidy of Adult bus fares is traffic congestion and there is very little congestion in Hobart and less in Burnie and Launceston.

Metro does not support the recommendation for a 30% adult fare increase.

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5 For the purpose of this calculation a figure of 480,000 is used.

6 It is recognised that Merseylink staff operate under different employment conditions and that the Contract Payments will include provisions for profit. These are offsetting influences.

7 Most Merseylink buses are ex-Metro vehicles plus a limited number of accessible buses.

8 The operator retains the farebox and the Government pays the net difference between costs and revenues.

Metro provides the following comments on the arguments presented by GPOC.

The information presented by GPOC in table 5.5 of the draft report indicates that urban bus fares are generally related to city size (considering the Metro fares as applying to Hobart). This relationship reflects conclusions drawn by Booz Allen Hamilton regarding public transport trip rates increasing with city size on a world-wide basis. The primary issues appear to relate to considering the price of public transport (adult fares) not in isolation, but rather in relative terms to private transport. As urban density increases the cost of private transport increases and Governments are able to increase the cost of public transport whilst keeping the relative price of public transport low so as to encourage public transport use. As the price of private transport declines the reverse is true. As the price of private transport increases (including such costs such as parking costs) then the ability to increase public transport fares also increases in terms of "what the market will bear".

Any attempt to apply a uniform price for public transport across urban centres will disadvantage smaller urban areas and actively discourage public transport use in those centres to a far greater extent.

Metro's view is that it is incorrect to try and relate Metro fares to an Australian average. Urban centres should be considered in 3 groups – centres over 2 Million (Sydney and Melbourne), centres between 800,000 and 2 Million (Adelaide, Brisbane and Perth) and centres below 800,000 (Darwin and Hobart)[9]. On this basis Metro adult fares are reasonable.

At the very least Sydney and Melbourne should be deleted from the sample set considered by GPOC, and this reduces the average difference to 15-20%.

Metro also considers that a factor that needs to be taken into account by GPOC is the ability of the community to pay. Tasmanian average weekly earnings are about 10% below the national average, and even further below the averages for Sydney, Canberra and Melbourne.

It is recognised that private sector Tasmanian adult fares are higher than Metro's fares. This is because in the private sector the Government does not provide any funding support for full fare adult passengers. Government subsidy support to private bus operators is only provided for the carriage of students and adult concession passengers. This enables the private sector bus operators to provide student travel for 30 cents (25% of Metro's single student fare). If GPOC consider that Metro adult fares should be adjusted to be more in line with Tasmanian private operator fares, then why shouldn't Metro's student and concession passenger fares also be adjusted to line up with the private sector.

Turning to GPOC's third argument for increasing adult fares. Encouraging reduced traffic congestion is a reason for subsidising urban public transport for full fare adults. In considering this element it is the relative price of travel by private as opposed to public transport that is the key to affecting traffic congestion. It has been noted earlier that the increases in the total cost of private travel in higher density cities enables the relative price of public transport versus private transport to be reduced whist still charging higher absolute levels for public transport as well.

[9] Canberra, which also falls into the smaller city grouping, has a flat adult fare of $2.40, which as an average fare is probably in line with the medium city grouping.

For Metro's fares to be increased by 30% would imply a Government policy position that favours private transport usage and all its associated urban problems. Metro believes that this is not consistent with Local and State Government policy positions regarding sustainable development and greenhouse strategies.

A more immediate concern to Metro relating to a 30% increase in Adult fares would be the impact on Adult patronage. Applying normal elasticity estimates would tend to indicate that a 30% increase in fares would result in a 10% decline in passenger numbers. However, the extent of passenger response will also be influenced by the scale of the price change and the change in the relative price of private versus public transport. Metro considers that a one-off 30% increase could well see a more substantial community response, with as much as a 20% reduction in adult passengers.

Metro is also concerned that a simple 30% increase across the board is not reasonable, and the opportunity should be taken to review section boundaries, the increments in fares with sections and the current policy of capping Metro fares for 11 sections and more. There are anomalies with the existing Adult fare structure as highlighted in Metro's submission. These also need to be addressed in association with DIER.

If there is a decision by Government to increase adult fares in line with GPOC recommendations then any increase should be phased in over a reasonable period of time rather than provided at one time as proposed.

Concession Fares

Metro supports the general conclusion that concession fares should not be increased, other than for the day-tickets.

GPOC have recommended that day-tickets increase by around 13-14%.

Metro believes that this would have a widespread impact on concession travellers due to the fact that it is the most popular ticket type for concession travellers. About 66% of concession traveller boardings in 2001/02 were associated with passengers using day tickets. The social consequences of such a change would be substantial. If an increase in day-ticket prices relative to single trip prices is considered appropriate then Metro would again favour a more staged approach. In the first instance any increase should be limited to $2.40 to enable the social impacts to be more closely monitored.

Metro still believes that a section based Concession fare structure has many social advantages, and would increase the demand for shorter distance travel by public transport. The argument that a flat fare system should be retained simply because the fare between Hobart and Bridgewater would increase does not appear sound. Many concession fares would fall, including Bridgewater to Glenorchy. However, such a change would have an impact on net fares revenues and hence on the level of Government contract payments. Concession fares on private sector buses are distance based. A review of this aspect (and others) could be undertaken at the time Metro's new ticketing system is introduced.

A minor point is that Metro was progressively moving to a standard discount policy for ten trip products of 20%. The GPOC recommendation regarding the price of a Senior ten day ticket is inconsistent with this policy.

Student/Child Fares

Metro believes that there is merit in having a separate fare structure for students and child passengers. This again reflects the approach adopted in the private sector. The child fare should logically equal the adult concession fare whilst the student fare would be a matter for Government policy.

Tertiary Students

The Commission recommends that tertiary student fares are to be increased by 30% in line with adult fares.

There is little supporting argument presented by the Commission.

Metro recognises that as a group tertiary students represent a wide cross-section, and that many tertiary students provided with Centrelink benefits will qualify for concessional travel.

However, overall Metro is of the view that the conclusions that it reached in responding to the Commission's recommendations for Adult fare increase apply equally well to tertiary students. Metro would thus argue that the level of increase recommended is not justified, and that if any significant increase is approved that any change be phased in.

Metro is in favour of consistency of fares policy between the private and public sector. It is acknowledged that GPOC is limited in its scope to only look at the fares policies for Metro. Metro will have greater flexibility to introduce more complex fare structures once a new ticketing system is introduced. The Commission could usefully identify potential candidate modifications for Metro to investigate with DIER for adoption at that time.

4 REVENUE IMPLICATIONS

The Commission has developed recommendations regarding the maximum revenues raised by Metro from the fare-box and Government contract payments of $29.15M in 2001/02 dollars, net of GST. This estimate is based on certain assumptions regarding expenditures, which Metro has addressed in section 3 above.

The other element of the equation is the net revenue from fares.

GPOC has identified the following fares increases:

- adult fares increased by 30%
- Tertiary student fare increase by 30%
- Concession and Senior day-tickets fares increase by 13-14%

In order to establish the impact of these changes on net fares revenues for Metro there needs to be consideration of the fares elasticity responses. Available data indicates that the elasticity responses are:

- Adults 30 to 60 % (the high figure of 60% reflects the scale of the change)
- Concessions 60 to 75%

- Tertiary Students 45 to 60%, between adult and concession passengers.
- Overall passengers 40 to 50%.

The impact on Metro fares revenues is dependent upon the elasticity response. Whilst the above estimates provide some indicative range, the actual response of passengers can tend to be higher if the scale of the price change is sufficiently large or the change in the relative price of public transport by comparison to competitors is large. A 30% increase in fares is likely to be considered large.

The expected impacts of the GPOC recommendations on Metro fares revenues (net of GST to Metro) are outlined in the following table.

From this analysis it can be seen that the impact on Metro's net revenue is expected to be about $376,000 after GST.

In section 4.6.1 the Commission summarises the combined effects of its conclusions about efficient Metro expenditure. This, when combined with conclusions regarding Metro fares revenues, will enable conclusions to be drawn regarding the appropriate level of contract payments.

Metro has significant concerns regarding the validity of the Commission's conclusions regarding efficient expenditure levels. As a consequence Metro has similar concerns about any conclusions that may be drawn about an appropriate level of Contract Payment based on the Commission's expenditure estimates.

TABLE 4.1 Estimated Revenue Implications Of GPOC Fare Recommendations

Passenger category	First Boardings	Net Fares Revenues	GPOC Fare Proposals	Low elasticity	High elasticity	Low "e" Revenue Change	High "e" Revenue Change
Adult singles (1)	1,547,597	$2,278,786	30%	-0.3	-0.6	$417,018	$150,400
Adult Day (2)	87,377	$134,480	30%	-0.3	-0.6	$24,610	$8,876
Concession singles (1)	1,063,427	$1,242,985	0%	-0.6	-0.75	$0	$0
Concession Day (3)	1,827,272	$1,714,738	13%	-0.6	-0.75	$71,779	$33,995
Child / Student	3,059,023	$1,695,958	0%	-0.4	-0.6	$0	$0
Tertiary Student	209,670	$216,050	30%	-0.4	-0.6	$31,111	$14,259
totals	**7,794,364**	**$7,282,996**				**$544,518**	**$207,530**

Notes

1 Includes single trip tickets and Metro 10 trip tickets

2 Includes Day Rover, Day-Rover 10 and Family

3 Includes Day-tripper, Day-tripper 10, Senior Day and Senior Day 10.

5 THE CSA AGREEMENT

Metro supports the principle conclusions of GPOC regarding revisions to the CSA Agreement and the nature of contract payments.

Metro sees significant merit is receiving a greater incentive to carry passengers by the introduction of a per passenger payment, with the potential for that payment to vary between different passenger types and different periods of time according to Government transport and social policy objectives.

The negotiation of a new CSA Agreement is about to commence and Metro would welcome clear guidance by Government on this matter.

In circumstances where contract payments are more directly related to passenger numbers there is a need for a return on capital to be provided for so as to accommodate the fluctuations that will arise from time to time in passenger levels. Also, there will need to be some flexibility to accommodate a return to the long-term trend decline in patronage levels. This would place increased patronage risk on Metro.

6 THE METRO INDEX

GPOC has proposed revisions in the Metro Index to correct problems that have been identified by Metro in its submission. These problems have also been recognised by the Department.

Metro is generally supportive of the recommendations made by GPOC with regard to changes to the Metro Index. There are however a number of specific issues to note.

As a general principle Metro remains of the view that the index used to adjust Metro's fares and contract payments should essentially be the same as that used for the private bus industry.

Metro recognises the comments made by the Department about the level of disquiet in the private bus industry regarding the current School Bus Index. It should be noted that the "parts and equipment" sub-index used in both the old Metro index and the School Bus Index is the same. The GPOC draft report has highlighted problems with this particular sub-index. It may be that adoption of the GPOC draft report recommendations with regard to this sub-index could see a resolution of all contract adjustment issues at the same time and in a consistent manner.

Metro remains of the view that a bus industry index should comprise of a weighted index of 4 sub-indices:

- Fuel
- Labour costs (wages plus overheads)
- Plant and equipment; and
- Other costs.

It is entirely reasonable to expect the weightings attached to these four sub-indexes to vary between different types of operations, but the basic sub-indexes should be the same.

Metro agrees with GPOC's identification of these four cost elements and the selection of sub-indexes for three of the four components. The one area where there is a difference of view relates to the labour index.

Fuel

Metro agrees with the conclusion reached regarding an appropriate fuel index.

Labour Costs

In relation to labour costs the Commission proposes to retain the use of the ABS index previously adopted, but to adjust it for changes in on-costs. The Commission considers that it is inappropriate for the labour index to directly reflect Metro wage outcomes as determined by Metro. Metro agrees with the Commission's conclusion that it is inappropriate to create a closed loop of directly compensating Metro for changes it makes to Metro wages. However, Metro has significant concerns that the ABS index proposed by GPOC does not adequately compensate Metro for labour cost movements associated with application of externally generated wage determinations.

Labour costs are the most significant cost item for Metro and it is essential that contract payment adjustments properly reflect National wage case outcomes.

Figure 10.1 from Metro's submission is reproduced here to illustrate the point that Metro's labour costs more closely track the labour index used within the School Bus Index than the ABS index selected to act as a proxy for Metro's labour costs.

It would appear that both the School Bus Index and Metro's actual labour costs are linked to the dollar increases flowing through from the national wage case decisions.

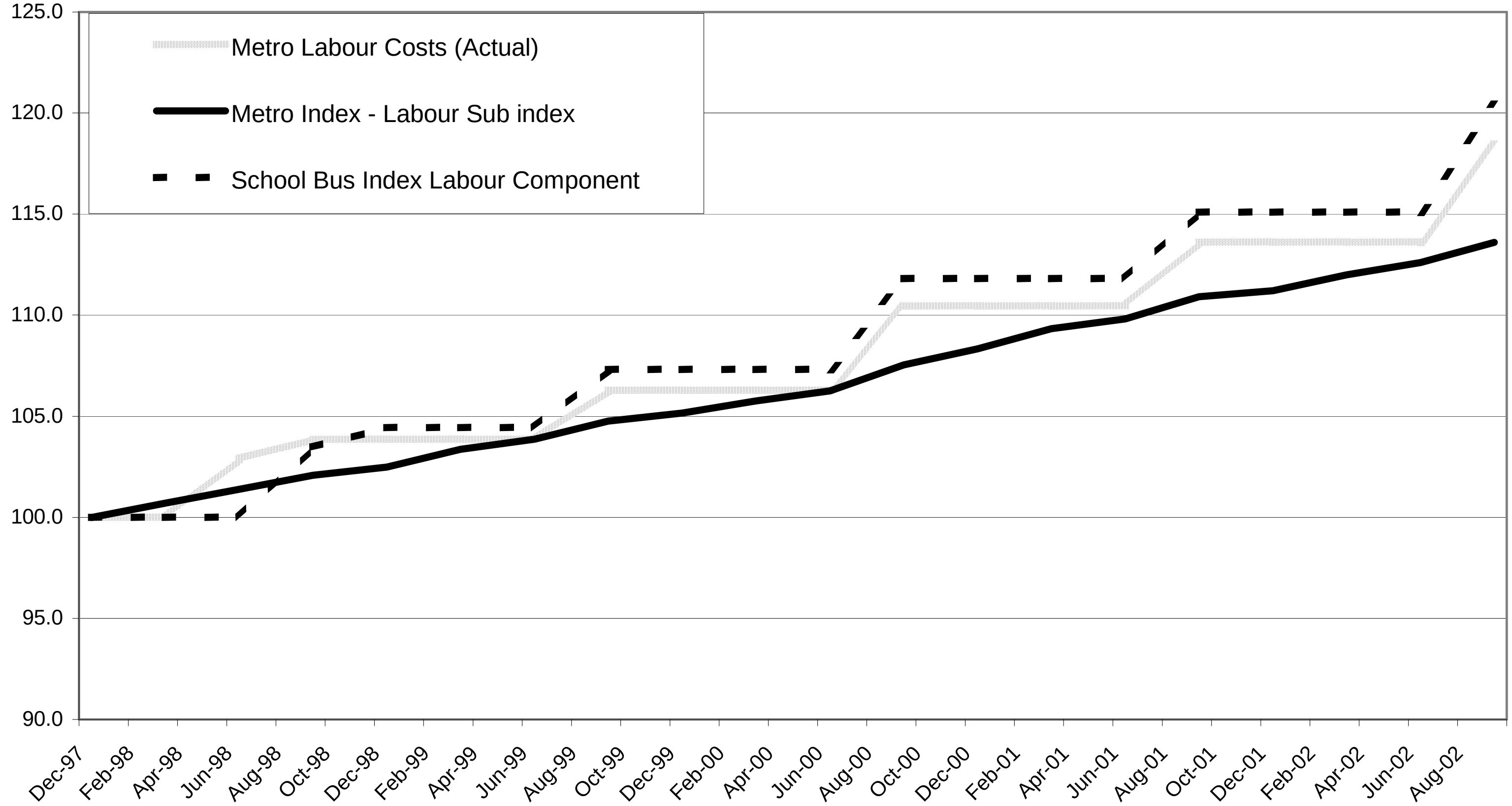
Metro would urge the Commission to review its conclusions in this area and explore the option of adopting the School Bus Index labour index, or some modified version of that approach. In coming to this conclusion Metro acknowledges the comments by the Department that changes are proposed to the School Bus Index, but understands that these changes may well be some time away.

Finally, Metro would like to comment on the approach proposed to adjust any wage index for changes to the "on-costs" of superannuation, workers compensation and payroll tax.

Metro considers that the basic approach adopted within the School Bus Index is appropriate with a basic wage cost index multiplied by an on-cost factor. It is considered more realistic for Metro and the Department to meet periodically to agree on the magnitude of the oncost factor. This could be done within the context of the CSA Agreement.

Metro would like to clarify the process envisaged for adjusting for workers compensation costs. If these are to be adjusted by the CPI then such costs are better included with "other costs" rather than labour costs, and the weightings adjusted accordingly.

Figure 10.1: Comparison of the Metro Index "Labour Sub-Index" with An Index of Actual Metro Labour Costs and the School Bus Index "Labour Sub-Index".



Parts and Equipment Costs

Metro agrees with the conclusion reached by the Commission regarding parts and equipment costs.

Metro notes the difficulties that have been encountered by other jurisdictions as well in trying to obtain a suitable indicator of cost movements for this component of bus costs.

Metro recognises that the use of the national CPI is a proxy for actual cost movements. Metro will maintain an index of its own costs in this area so that we can provide feedback on the on-going relevance of the CPI as a suitable proxy.

Other Costs

Metro agrees with the conclusion reached by the Commission regarding this cost component.

7 CONCLUSIONS

The most important conclusion that can be reached from the draft GPOC report is that Metro is the most efficient public sector bus operator in Australia by a significant margin and that it is also has lower costs than the majority of private bus operators surveyed by INDEC Consulting.

Metro management will continue to explore opportunities to achieve efficiencies.

The efficient cost benchmarks that have been identified by the Commission are not considered realistic. It is believed that if these are to be pursued then there will need to be significant changes to Metro's operating environment (particularly in the contestability of service provision) with dramatic flow on impacts to employee awards and conditions. There will be transitional costs associated with such changes, and these will need to be identified and responsibility allocated.

In terms of cost-effectiveness to Government the bottom line is the cost per kilometre of bus services it purchases. Metro has estimated that the Government spends 27% more in purchasing each kilometre of urban bus services in Devonport than it does in purchasing equivalent services from Metro.

Metro does not support the proposal to increase Adult or Tertiary student fares by 30%. Metro believes that no strong case has been made for such a substantial increase, and it is feared that the adoption of such a recommendation would have a major impact on patronage levels at a time when Metro is achieving some success in moving away from the long-term historical decline in public transport passenger numbers. Any changes that are made to these fares should be phased in.

Metro is also concerned that the proposals by GPOC to increase the day ticket fares for Seniors and Concession passengers will have serious social implications, given the high level of utilisation of this ticket type. Any changes that are made to these fares should also be phased in.

Metro believes that the sub-index to be used as a proxy for Metro's labour costs (including on-costs) should be based on the labour cost index used for the School Bus Index.